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25X1A ONE ARTICLE FROM OER'S ECONOMIC INTELLIGENCE WEEKLY REVIEW
ENDING 16 FEBRUARY 1978. REQUEST ARTICLE BE PASSED TO AMBASSADOR,
DCM, ECONOMIC SECTION AND OTHER WORKING LEVEL STATE OFFICERS.

SPAIN: AUSTERITY LIKELY TO PUT SUAREZ ON DEFENSIVE.

1. THE MODERATE GOVERNMENT OF PRIME MINISTER ADOLFO SUAREZ IS PURSUING AN AUSTERE ECONOMIC PROGRAM--THE MONCLOA PACT--THAT WILL PUSH UNEMPLOYMENT UP FURTHER AND RESULT IN ANOTHER YEAR OF SLOW GNP GROWTH. WITH THE FOCUS ON INFLATION AND THE CURRENT ACCOUNT BALANCE RATHER THAN ON JOBS, THE OPPOSITION, LED BY SOCIALIST FELIPE GONZALEZ, AND THE FEISTY LABOR LEADERS HAVE A POTENT ISSUE IN THE MONTHS AHEAD. IF HIS CRITICS SUCCESSFULLY EXPLOIT THIS ISSUE, THE POLITICALLY ADEPT SUAREZ CAN WATER DOWN HIS AUSTERITY PROGRAM.

ECONOMIC DIFFICULTIES.

2. SPAIN'S RECENT ECONOMIC ILLS BEGAN IN THE TWILIGHT OF THE FRANCO ERA AND WERE EXACERBATED BY OIL PRICE RISES AND THE INTERNATIONAL RECESSION. TO ERASE GROWING LABOR PROBLEMS, FRANCO BOUGHT WORKER TRANQUILITY BY GRANTING ENERGENS PAY HIKES AFTER 1973. THE RESULTING WAGE-PRICE SPIRAL WAS FULLY ACCOMMODATED BY THE MONETARY AUTHORITIES. FURTHER COST INCREASES STEMMING LARGELY FROM THE 1973/74 OIL PRICE HIKES SEVERELY WORSENERED THE TRADE AND CURRENT ACCOUNT DEFICITS.

3. PRIME MINISTER SUAREZ BELIEVED THAT VIGOROUS CORRECTIVE ACTION AT A TIME OF POLITICAL TRANSITION WOULD THREATEN THE "DEMOCRATIZATION" OF SPAIN. FOLLOWING NATIONAL ELECTIONS LAST JUNE, HOWEVER, SUAREZ FOCUSED HIS EFFORTS ON HOLDING DOWN DEMAND TO CURB

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RAMPANT INFLATION AND REDUCE THE TROUBLESOME CURRENT ACCOUNT DEFICIT. AS A RESULT, WHILE INFLATION HAS BEGUN TO EASE FROM ITS 30-PERCENT PEAK, UNEMPLOYMENT IS ON THE RISE.

4. THE REGISTERED UNEMPLOYED NOW NUMBER ABOUT 600,000; TOTAL UNEMPLOYMENT MAY EXCEED 1 MILLION OUT OF A WORK FORCE OF 13.2 MILLION. IF SPAIN CONTINUES ON THE AUSTERITY PATH, TOTAL UNEMPLOYMENT COULD REACH 1.5 MILLION OR 11 PERCENT OF THE WORK FORCE BY YEAREND. WEAK DEMAND AND RISING COSTS ARE SQUEEZING PROFITS; BUSINESSES SEEKING CREDIT ARE ENCOUNTERING HIGH SHORT-TERM INTEREST RATES. INVESTMENT HAS SLUMPED, AND BUSINESS FAILURES ARE ON THE RISE.

MONCLOA PACT A HARSH PRESCRIPTION.

5. OPPOSITION PARTIES ARE LIKELY TO MAKE HIGH UNEMPLOYMENT AND OTHER SIDE EFFECTS OF THE GOVERNMENT'S ECONOMIC PROGRAM A POLITICAL ISSUE EVEN THOUGH CURRENT POLICY IS IN ACCORD WITH THE INTERPARTY MONCLOA PACT SIGNED LAST OCTOBER. THE PARTY REPRESENTATIVES AGREED TO SUPPORT MONETARY AND FISCAL RESTRAINT AND WAGE GUIDELINES. UNDER THE PROGRAM, FIRMS MAY DISMISS UP TO 5 PERCENT OF THEIR WORKERS IF WAGE SETTLEMENTS EXCEED WAGE GUIDELINES, AND THE GOVERNMENT CAN DENY CERTAIN FINANCIAL ASSISTANCE, SUCH AS TAX AND EXPORT CREDITS, TO FIRMS GRANTING EXCESSIVE PAY INCREASES. LEFTIST PARTIES RECEIVED SOME BALANCING CONCESSIONS: LABOR UNION RECOGNITION, A SYSTEM OF UNEMPLOYMENT COMPENSATION, A MORE PROGRESSIVE TAX STRUCTURE, A FEW EMPLOYMENT-GENERATING INVESTMENTS, AND SOME HOUSING AND EDUCATION PROGRAMS.

6. THE TWO-YEAR ECONOMIC STABILIZATION PROGRAM AIMS AT SLOWING INFLATION TO A 10-PERCENT ANNUAL RATE AND REDUCING THE CURRENT ACCOUNT DEFICIT TO \$1.5 BILLION, AT THE SAME TIME MAKING THE ECONOMY MORE RESPONSIVE TO MARKET FORCES. ON THE AVERAGE, CONSUMER PRICES WERE ABOUT 27 PERCENT HIGHER IN 1977 THAN IN 1976. LAST YEAR'S CURRENT ACCOUNT DEFICIT OF \$2.8 BILLION WAS \$1.5 BILLION BELOW THE 1976 PEAK--THANKS MAINLY TO RESURGENT TOURISM--BUT STILL WAY SHORT OF THE GOAL.

7. SPANISH ECONOMIC CZAR FUENTES QUINTANA HOPES TO SLOW INFLATION TO ABOUT 20 PERCENT THIS YEAR AND CUT THE CURRENT ACCOUNT DEFICIT TO \$2.5 BILLION. TARGETS TO MEET THE GOALS INCLUDE A 17-PERCENT GROWTH IN THE MONEY SUPPLY

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AND A 22-PERCENT LIMIT ON WAGE HIKES.

ANOTHER LEAN YEAR AHEAD.

8. THE ECONOMIC OUTLOOK FOR GNP AND JOBS IN 1978 IS POOR; PROSPECTIVE DECLINES IN THE INFLATION RATE AND THE CURRENT ACCOUNT DEFICIT ARE THE BRIGHT SPOTS. MADRID RECENTLY CUT ITS PROJECTION OF REAL GNP GROWTH FROM 1.1 PERCENT TO A MINISCULE 0.5 PERCENT; GROWTH OF 4 PERCENT IS NEEDED TO KEEP UNEMPLOYMENT FROM RISING. THE GNP PROJECTION PROBABLY WAS REVISED BY SCALING DOWN THE ORIGINAL FORECAST OF A 13-PERCENT INCREASE IN EXPORT VOLUME. THAT FORECAST WAS OVEROPTIMISTIC SINCE THE VOLUME OF INTRA-OECD TRADE APPEARS HEADED FOR A RISE OF ONLY 4 TO 5 PERCENT.

9. THE STABILIZATION PROGRAM SHOULD REDUCE THE CURRENT ACCOUNT DEFICIT SEVERAL HUNDRED MILLION DOLLARS IN 1978 EVEN IF EXPORTS RISE MUCH LESS THAN FIRST PREDICTED. EXPORTS WILL BENEFIT FROM LAST YEAR'S 20-PERCENT DEPRECIATION OF THE PESETA, ALTHOUGH INFLATION IS ERODING THE GAIN. TRADE IN AGRICULTURAL PRODUCTS WILL BE MORE FAVORABLE THAN IN 1977, WHEN THE IMPACT OF THE 1976 DROUGHT STILL WAS BEING FELT. THE UPSWING IN TOURISM SHOULD CONTINUE. ON THE NEGATIVE SIDE, TRADING PARTNERS WILL EXPERIENCE NO MORE THAN MODERATE GROWTH IN PRODUCTION AND IMPORT DEMAND. SPANISH FIRMS REPORTEDLY ARE SLICING THEIR SHIPBUILDING AND REPAIR CAPACITY BECAUSE OF THE WORLDWIDE SLUMP AND STRONG JAPANESE COMPETITION. FURTHERMORE, SPAIN WILL BE HURT BY MEASURES TAKEN TO PROTECT THE STEEL AND TEXTILE INDUSTRIES OF THE EUROPEAN COMMUNITY.

10. FISCAL POLICY WILL GIVE THE SPANISH ECONOMY ONLY A SMALL PUSH, WITH THE BUDGET DEFICIT EXPECTED TO APPROXIMATE 1.5 PERCENT OF GNP. OUTLAYS FOR UNEMPLOYMENT COMPENSATION WILL BE INCREASED, AND A PORTION OF SOCIAL SECURITY COSTS HAS BEEN SHIFTED FROM PAYROLL TAXES TO GENERAL REVENUES TO AID BUSINESSES AND ENCOURAGE HIRING. THE GOVERNMENT FINANCES A LARGE PART OF THE BUDGET DEFICIT BY BORROWING ABROAD. WITH INTERNATIONAL RESERVES OF MORE THAN \$6 BILLION AND FOREIGN DEBT STILL AT A MANAGEABLE LEVEL, MADRID WILL NOT ENCOUNTER PROBLEMS IN WORLD FINANCIAL MARKETS.

11. GIVEN LUKEWARM DOMESTIC AND FOREIGN DEMAND, BUSINESS CAN BE EXPECTED TO CALL FOR THE EASING OF CREDIT RESTRAINTS THIS YEAR AS BANKRUPTCIES INCREASE. THE INEVITABLE RISE IN UNEMPLOYMENT MAY FIND BUSINESSMEN AND

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ABOR ON THE SAME SIDE CALLING FOR A RELAXATION OF AUSTERITY MEASURES.

POLITICAL CURRENTS.

12. THE SOCIALIST PARTY (PARTIDO SOCIALISTA OBRERO ESPANOL, OR PSOE), LED BY FELIPE GONZALEZ AND ITS LABOR AFFILIATE, UNION GENERAL DE TRABAJADORES (UGT), ARE LIKELY TO EMERGE AS THE MOST IMPORTANT CRITICS OF THE GOVERNMENT ECONOMIC PROGRAM IN THE COMING MONTHS. THE PSOE, THE LARGEST OPPOSITION PARTY, HAS BEEN UNEASY WITH THE MONCLOA PACT FROM THE BEGINNING BECAUSE OF ITS DEFLATIONARY CAST AND ITS FREE MARKET ORIENTATION. THE SOCIALISTS WERE PUSHED INTO SIGNING THE AGREEMENT WHEN THE COMMUNISTS AND ALL OTHER MAJOR PARTIES ENDORSED IT.

13. AS JOBLESSNESS CONTINUES TO RISE, THE PSOE PROBABLY WILL CHARGE THE GOVERNMENT WITH INSENSITIVITY TO THE WORKER, MAKING UNEMPLOYMENT A CENTRAL ISSUE IN ITS DRIVE TO COME TO POWER BY MID-1979. GONZALEZ AND COMPANY WILL AVOID RENOUNCING THE GOALS OF THE MONCLOA PACT TO AVERT A LOSS OF SUPPORT ON THEIR RIGHT WING, BUT THEY CAN BE EXPECTED TO DEMAND A SLOWDOWN IN THE AUSTERITY PROGRAM.

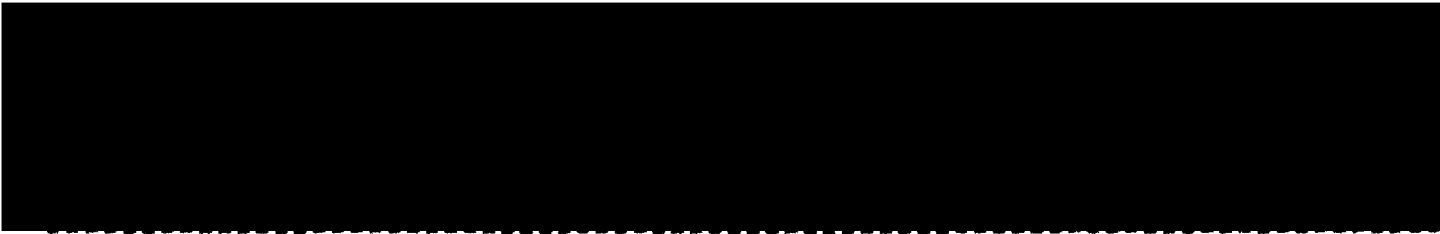
14. THE SOCIALISTS NEED TO BROADEN THEIR BASE OF SUPPORT BEFORE MAKING A BID FOR CONTROL OF THE GOVERNMENT. THE UGT IS WINNING LABOR ELECTIONS IN MANY OF SPAIN'S LARGEST INDUSTRIAL PLANTS, ALTHOUGH THE COMMUNIST-DOMINATED WORKERS COMMISSIONS ARE OUTPOLLING THE UGT 3 TO 2 NATIONWIDE ACCORDING TO THE LATEST GOVERNMENT FIGURES. THE PSOE HOPES TO USE THE MUNICIPAL ELECTIONS--WHERE IT EXPECTS TO WIN MOST OF THE LARGE CITIES--TO BUILD UP MOMENTUM THAT WOULD CARRY THE PARTY TO POWER IN THE NEXT LEGISLATIVE ELECTIONS. KNOWING THIS, PRIME MINISTER SUAREZ MAY OPT TO HOLD THE LEGISLATIVE ELECTION FIRST, PERHAPS AS EARLY AS THIS SUMMER FOLLOWING RATIFICATION OF THE NEW CONSTITUTION, FOR WHICH HE WILL CLAIM MAJOR CREDIT.

15. SUAREZ IS A MASTER TACTICIAN AND HAS IN THE PAST FREQUENTLY CO-OPTED LEFTIST DEMANDS. HIS ADAPTABILITY AND THE FLUID NATURE OF SPANISH POLITICS SUGGEST THAT THE OVERNING UNION OF THE DEMOCRATIC CENTER WILL MODIFY ITS AUSTERITY PROGRAM IF SOCIALIST ATTACKS PROVE EFFECTIVE. IN THIS EVENT, SUAREZ WOULD CALL FOR MORE MEASURES TO GENERATE EMPLOYMENT AND WOULD EXTEND BY A COUPLE OF YEARS HIS ORIGINAL 1979 TARGETS FOR INFLATION AND THE CURRENT

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ACCOUNT DEFICIT. A SHIFT IN TARGETS WOULD NOT ELICIT
ANY SERIOUS INTERNATIONAL CONCERN, GIVEN THE MODERATE
LEVEL OF SPANISH FOREIGN DEBT, THE HIGH LEVEL OF RESERVES,
AND LAST YEAR'S IMPROVEMENT IN THE CURRENT ACCOUNT.

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